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DEPARTMENT OF JUSTICE

Antitrust Division

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October 8, 1997

William F. Caton
Acting Secretary
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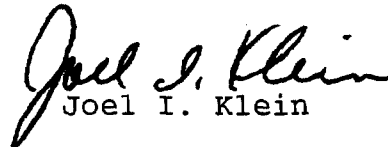
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Dear Mr. Caton:

The Justice Department has submitted the attached comments regarding the Commission's request for comments on competitive bidding rules to Chairman Hundt, with copies to Commissioners Quello, Chong and Ness.

Thank you for your cooperation in this matter.

Sincerely,


Joel I. Klein

JIK/jhb

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October 8, 1997

Chairman Reed Hundt
Federal Communications Commission
Room 814
1919 M Street, N.W.
Washington, DC 20554

Re: Request for Comments on the Notice of Proposed Rulemaking on the FCC's
General Competitive Bidding Rules for All Auctionable Services

Dear Chairman Hundt:

The Commission has sought comment on a variety of proposals and tentative conclusions set forth in its Notice of Proposed Rulemaking ("Notice") regarding its competitive bidding procedures.¹ Because the Justice Department is concerned with ensuring a competitive bidding process, we submit these views on the Commission's proposals in Section IV, Part E -- Competitive Bidding Design, Procedure, and Timing Issues, and Section IV, Part F -- Rules Prohibiting Collusion.

On the proposal for minimum opening bids, the Department believes that other measures may be more effective in protecting the integrity and competitiveness of the Commission's auction

¹See In the Matter of Amendment of Part 1 of the Commission's Rules -- Competitive Bidding Proceeding, W.T. Docket No. 97-82, Order, Memorandum Opinion and Order and Notice of Proposed Rulemaking, " (rel. Feb. 28, 1997).

process. To be sure, minimum opening bids may be beneficial if applied to situations in which there are few bidders in a market and therefore an increased risk that tacit or explicit collusion would result in the acquisition of spectrum for significantly less than its fair market value. We also recognize that minimum bids may speed up the auction. Nonetheless, minimum bid restrictions pose some significant risks that the minimum will be mistakenly set above fair market value, thereby delaying the sale of the spectrum and the introduction of new services consumers desire. Accordingly, we recommend that the Commission should first try to address the problem of a lack of competition directly by redesigning the auction and/or applying stricter scrutiny to applications for joint bidding. If the Commission should decide to institute minimum bid requirements, it should consider doing so only in limited circumstances (i.e., where there are only a few bidders).

The Department also recommends that the Commission limit the number of bid withdrawals as it did in its recent announcement regarding auction procedures for the 800 MHz Specialized Mobile Radio Auction (Auction No. 16),² and end the use of trailing digits on bids. These two measures would make signaling more difficult, thereby minimizing the risk of tacit collusion by bidders, and would speed up the auction process.

Finally, the Department recommends that if the Commission amends its anti-collusion rules to include "safe-harbor" treatment to allow for discussions of merger, acquisition, or other intercarrier arrangements during the auction process, it should not permit negotiations involving resale or roaming agreements for markets where two firms are currently bidding against each

²See *Public Notice*, "FCC Announces Changes to Auction Procedures for the 800 MHz SMR Auction (Auction No. 16)," DA 97-1934 (rel. September 5, 1997) ("September 5th Public Notice").

other. Such negotiations increase the risk of an agreement between two firms to allow one to “win” the market cheaply and share the amount saved by not bidding against each other. Although allowing for merger discussions during the auction process may facilitate efficiency-enhancing combinations, it is important that the Commission impose a notification requirement on any such discussions so that potential anticompetitive arrangements can be detected. Finally, we note that, to the extent the auctions are significantly abbreviated in time, a safe-harbor rule to allow for merger discussions (or other intercarrier arrangements) may no longer be necessary.

A. COMPETITIVE BIDDING DESIGN

(1) Minimum Opening Bids

Under current rules, the Commission may establish *suggested* minimum opening bids.³ The Commission may also set a reservation price if only two or three applicants have applied to bid for a valuable license in order to minimize the risk of tacit and explicit collusion among the few bidders.⁴ The Commission proposes to modify the rules to provide for minimum opening bids, rather than suggested opening bids, which will have the virtually the same effect as setting a reservation price.⁵ The purpose is two-fold: to increase the likelihood that the public receives fair market value for the license and to speed up the auction.

The use of minimum opening bids may be beneficial in some circumstances. For instance, they may be useful when there are only small number of bidders and therefore, an increased risk of

³47 C.F.R. § 1.2104(d).

⁴*Competitive Bidding Second Report and Order*, 9 FCC Rcd at 2384, ¶ 207.

⁵*Notice*, ¶ 86.

tacit and explicit collusion that would permit a party to acquire spectrum at less than fair market value. Minimum opening bids may also provide the added benefit of speeding up the auction. These benefits are not costless, however. To realize the value inherent in licensing spectrum with only a few bidders, a minimum bid must be set relatively close to the estimated value of the spectrum. If the Commission overestimates this value, the spectrum will not be sold, and services consumers desire will not be developed in a timely fashion.

We recommend that the Commission consider whether it can address the problem of too few bidders directly. First, the current auction design may discourage some bidders. For example, if the FCC proceeds from announcement to auction too quickly, firms may have insufficient time to make plans and line up the required financing. Similarly, if the FCC encumbers the spectrum with restraints that make commercialization difficult, uncertainty about the value of spectrum may be very high, and few firms may be willing to bid. The Commission could remedy these problems by increasing the time between announcement and the auction or by reconsidering the conditions attached to the spectrum.

Second, incumbent firms' joint ventures or other bidding arrangements, which are currently legal under the FCC rules, may limit the number of competitors. Currently, competing bidders need only notify the Commission that they are in a "joint venture" prior to the start of the auction. There is a significant difference between (1) a group of firms that decides to pool its resources, jointly bid, and jointly develop service; and (2) a group of firms that simply plans to jointly bid and later divide up the spectrum among themselves to develop independently. The former offers the potential for new service otherwise unavailable, while the latter merely eliminates competition among bidders. To address this problem, the FCC could reject

applications to jointly bid on spectrum where there does not seem to be a genuine efficiency involved. In general, such efficiencies will be present when the group of bidders can collectively offer a more attractive product than they would be able to offer were they to bid on an individual basis, or if those bidders would be unable, or unlikely, to submit a bid absent that particular joint venture.

We recognize that these direct approaches may not always be feasible. The Commission may not be able to increase the notice period, or it may not be able to develop and enforce basic restrictions on joint bidding arrangements. If the Commission determines that this is indeed the case, it may be that setting minimum bids -- at least where there are few bidders -- and re-auctioning unclaimed spectrum at a later date would be a "second best" solution to the problem of limited competition.

(2) *Use of Bid Withdrawals*

The Commission has requested comment on whether it should limit the number of bid withdrawals permitted to any individual firm, and if so, under what circumstances.⁶ The Notice explains that there are legitimate reasons for allowing bid withdrawals, including correction of mistakes,⁷ as well as allowing efficient aggregation of licenses. On the other hand, bid

⁶Notice, ¶ 93.

⁷Under the current rules, if a high bid is withdrawn prior to the close of a simultaneous multiple round auction, the Commission will impose a payment equal to the difference between the withdrawn bid and the amount of the winning bid the next time the license is offered by the Commission. (Notice, at ¶ 89.) In this respect, the bidder who withdraws is still liable for the mistake. No withdrawal payment is assessed if the subsequent winning bid exceeds the withdrawn bid. (*Id.*)

withdrawals can be used to signal rival bidders, since they provide a tool for emphasizing a bid. For example, a firm can threaten to bid in a particular market by bidding and then withdrawing a bid. As long as such withdrawals are superseded by other bids in later rounds, they provide a costless way to communicate with other bidders and could be used in a strategic fashion.

In the recent auction of broadband PCS licenses for blocks D, E, and F, a total of 789 bids were withdrawn, or less than two per basic trading area ("BTA"). Although the majority of the withdrawals appear to have been innocuous, some firms may have used repeated withdrawals within the same market for reasons unrelated to creating efficient aggregations. In one instance, a firm, which was not the eventual winner, withdrew six out of eight bids it made over 25 rounds in one BTA. Certain firms also appear to have used withdrawal rights more extensively than should be necessary in an ordinary bidding strategy. In particular, three firms accounted for over 360 withdrawals, or approximately 46% of all bids withdrawn during the auction. This aggressive withdrawal strategy does not appear to have depended upon the number of bids a firm made. For example, one large bidder that participated widely in many markets in the PCS auctions withdrew fewer than 2% of its total bids in the auction, indicating that effective auction strategies can be conducted without excessive numbers of bid withdrawals.

Withdrawals create two problems. First, as the Commission notes, withdrawals may be used to communicate bidding strategies (or threatened bidding strategies). Although firms could attempt to use an ordinary bid in much the same way as a withdrawn bid to send a signal, an ordinary bid does not convey the same level of information. Firms make bids with the intention of winning all the time. Distinguishing between a bid that is intended as a signal from a bid that is an actual attempt to win the auction is difficult. With a withdrawn bid, the firm can highlight a

particular bid without increasing the price level of a license. By withdrawing a bid, a firm also can suggest to a second firm that it will allow that the second firm to take its place without increasing the bidding level. Such an "offer" may also be accompanied by a trade whereby the second firm stops bidding or withdraws from a contested market.

Withdrawals also appear to have been widely used to manage eligibility levels. Rather than bidding directly on blocks of spectrum of interest, some firms may bid elsewhere to preserve their eligibility while not driving prices higher in markets of interest to themselves. These "parking" strategies could be used repeatedly to retain large amounts of eligibility by repeatedly bidding and withdrawing in markets. Since this activity does not provide any new information to the bidders about the underlying value of the spectrum, this use of withdrawals simply delays resolution of the auction.

In the most recent announcement regarding auction procedures for 800 MHz Specialized Mobile Radio Auction (Auction No. 16), the Commission announced that it will be limiting the number of rounds in which a bidder may place withdrawals.⁸ Specifically, each bidder will be allowed two rounds (at the bidder's discretion) in which it may withdraw bids on an unlimited basis.⁹ We support the Commission's proposal and urge the Commission to adopt this rule for all types of auctions. This restriction would limit the use of withdrawals to communicate bid strategies, while still allowing for a change in strategy by a firm not attempting to use a withdrawal to send a signal. (If the FCC is auctioning spectrum for a nationwide license rather than regional licenses for individual BTA's, then there is no need for any withdrawals at all, and

⁸See September 5th Public Notice.

⁹*Id.* at 2.

each bid should simply be allowed to stand until it is superseded.) The Commission should not, however, penalize a withdrawing bidder by reducing its eligibility. A legitimate use of withdrawals is to change the aggregation of markets a firm is bidding upon, and a firm may need that eligibility to bid in other markets. If a firm withdraws from one market and decides not to bid elsewhere, then its eligibility will fall as the rules provide. If the firm elects to bid, the auction will move forward with a higher valuation on the firm's next best alternative.

(3) *Use of Trailing Digits*

Current FCC auction rules do not prohibit the use of "trailing" digits -- that is, the use of the last few digits of a bid. Trailing digits, however, can be used to signal information about bid strategies. For example, bidders can point to markets by ending a bid with a market number. The use of trailing digits has been observed in several auctions, and may be a particularly effective signal in auctions with limited competition, such as the recent PCS auctions. Such signaling, which is virtually costless, appears to have been especially pervasive in the DEF broadband PCS auction. Based on the available evidence and a formal complaint filed with the FCC, it is clear that bidders received and understood these signals. We believe the Commission should adopt a simple solution to this problem: the Commission should require all bids to be in increments no smaller than \$1000. Given the size of the bids obtained for most spectrum, this minimum bid increment would not significantly limit information about the value of spectrum or the overall government revenue raised.¹⁰

¹⁰We recognize that if the FCC bars trailing digits, the bidders may devise other means to signal. The Commission should remain alert to this potential problem.

B. PROPOSED SAFE-HARBOR FROM RULES PROHIBITING COLLUSION

The Commission, in its *Competitive Bidding Second Report and Order*,¹¹ adopted rules to prohibit collusion because such conduct could undermine the competitiveness of the bidding process and prevent the formation of a competitive post-auction market structure.¹² In general, the anti-collusion rules require that bidders identify on their short-form applications any parties with whom they have entered into any consortium, joint ventures, partnerships or other agreements that relate to the competitive bidding process. Between the time the short-form applications are filed and the winning bidder makes its required down-payment, all bidders are prohibited from cooperating, collaborating, discussing or disclosing in any manner the substance of their bids or bidding strategies with other bidders, unless such bidders are members of a joint bidding arrangement identified on the bidder's short-form application.¹³ The Commission intended to rely primarily upon these safeguards and the antitrust laws to detect and prevent collusion in the competitive bidding process. The Commission recognized the need to strike a balance between preventing collusion and facilitating the formation of efficiency-enhancing bidding consortia that pool capital and expertise and reduce entry barriers for smaller firms that otherwise might not be able to compete in the auction process. If the anti-collusion rules were too strict or overbroad, they might have a chilling effect on legitimate business transactions.

In its Notice, the Commission seeks comment on a proposed "safe-harbor" from the anti-

¹¹*Competitive Bidding Second Report and Order*, 9 FCC Rcd at 2387, ¶ 225.

¹²*Notice*, at ¶ 98.

¹³47 C.F.R. § 1.2105(c)(1).

collusion rules to allow auction participants to engage in discussions involving a merger, acquisition, or intercarrier arrangements (roaming agreements, resale agreements, and joint purchasing arrangements, among others).¹⁴ Under this proposal, the persons involved in such agreements would certify that they are not discussing bidding strategy or otherwise divulging bid information in violation of the anti-collusion rules.

(1) Speeding Up the Auction Process

The safe-harbor proposal attempts to address problems arising because auctions take too much time to complete. From the pre-auction notification stage until the auction closes can take more than six months; during this time, bidders may be restricted by the anti-collusion rules from undertaking actions that are not anticompetitive. Firms have complained that because the telecommunications marketplace is so dynamic, they may need to enter into merger discussions unrelated to the auction process. Although this is a legitimate concern, the possibility that competition in the auction could be reduced by collusion is also a real threat. Most spectrum is valuable to a limited number of competitors because of the network qualities of the service -- firms value service in a number of contiguous areas more than scattered bits of spectrum across the country. For example, in the recent broadband PCS auctions the number of bidders in any block was fairly limited in most markets.

There would be much less need to alter the anti-collusion rules if the Commission simply speeded up the auction. This could be accomplished by adopting other proposed rules. In

¹⁴The Commission also proposes modifying the rules to allow entities to invest in multiple applicants if the original applicant withdraws from the auction. We agree with this proposed modification.

particular, limiting the number of withdrawals could considerably shorten the auction.¹⁵ In the recent PCS auction, for example, a large number of rounds in many markets were consumed with bids and withdrawals that did not advance prices. If the auction progresses more quickly, then the potential harm from collusion to the government from reduced revenues may reasonably outweigh the short run efficiency cost of anti-collusion rules. If so, a safe-harbor exception to the anti-collusion rules might no longer be necessary, as the time in which parties could not discuss entering into resale or roaming agreements, or mergers would decrease considerably.

(2) *Resale or Roaming Agreements*

If the Commission nonetheless adopts a safe-harbor to its anti-collusion rules, the Department recommends that the Commission not permit parties to negotiate resale or roaming agreements for markets in which they are currently bidding against each other.¹⁶ In our view, if parties are allowed to engage in such discussions, there is a high potential for anticompetitive results if such agreements are reached during an auction.¹⁷ In particular, they could be used to

¹⁵The Justice Department also supports the Commission's effort to speed the auction by the use of "click box" bidding, as set forth in the September 5th Public Notice. We urge the Commission to consider adopting this for all auctions utilizing the electronic bidding system, and note that it would have the salutary effect of precluding bids with trailing digits.

¹⁶The prohibition should also bar an agreement for access to spectrum currently up for bid or spectrum in the same market obtained previously by one of the parties.

¹⁷We do not object to safe-harbor treatment for firms engaged in roaming or resale agreements *outside* of the geographic regions where they are active bidders or current service providers. However, such a rule would be difficult to apply until the auction is well advanced, since many firms claim to be planning to bid in "all markets" on their form FCC-175 to maximize their options for bidding strategy. To make the safe-harbor rule workable, the FCC may consider allowing firms to amend their short form applications to reduce the geographic area they are bidding on. Such an amendment could also help clarify when a firm has "dropped out" of the auction as the Commission contemplates in the *Notice*, at ¶ 101.

compensate a firm for agreeing not to bid against another in a market. The “winning” firm could give the other firm an unusually favorable roaming or resale agreement for the previously-contested market, in essence, sharing the amount saved by not bidding against each other. Unlike other types of agreements to reduce competition, neither firm would have to compensate the other for exclusion from the market.

(3) Mergers and Acquisitions

Mergers between potential competitors for spectrum in an auction present a problem for antitrust enforcement. By agreeing to merge, two companies could reduce or eliminate their incentives to bid against each other for spectrum. Depending upon the timing of the merger announcement (which the parties can control), the ordinary antitrust merger review process may not begin until after the auction is concluded, by which point the two companies are no longer competitors for spectrum in the auction because the auction is over. At that point, finding a violation under Section 7 of the Clayton Act, and administering any appropriate remedy, might be substantially more difficult because the auction for the spectrum had already been concluded. Thus, a lessening of competition in the spectrum auction through a merger might elude regular merger enforcement.

On the other hand, unlike resale or roaming agreements, mergers are not necessarily a cost effective tool for arranging a collusive agreement. Even if acquiring a competitor would reduce competition in the auction, the significant costs associated with negotiating and executing such agreements might make a merger an unattractive mechanism for colluding unless the amount of

competition reduced is substantial.¹⁸ In addition, some mergers may enhance the combined companies' ability to compete and increase efficiency with little or no impact on competition. Mergers of firms that are not competing against each other in a given region are one obvious example. Likewise, mergers of firms that were competing but have dropped out of an auction prior to any merger discussion (as is contemplated in the FCC's *Notice* in ¶ 101) do not pose a competitive problem.

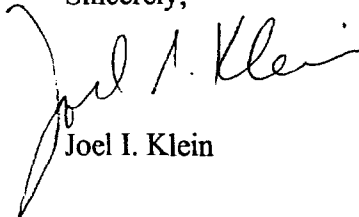
Although it is possible that merger discussions during an auction may reduce competition for spectrum, designing a simple rule that does not impede efficient mergers may be impossible. In our experience, determining which mergers are harmful and which are beneficial is not an easy task. Thus, if the Commission decides to permit firms to engage in merger discussions during an auction, it should require the parties to notify the FCC of their intent to enter into such discussions. In addition, the Commission might wish to reserve the right to prohibit merger discussions in two circumstances: (1) where prior to the beginning of the auction, but after submission of the short form applications, the ratio of bidding eligibility to total spectrum is low, or (2) where during the auction it is clear that the two firms are actively bidding against each other in a number of markets.

¹⁸If the Commission decides to amend its rules to allow merger discussions, it should make clear that the exception is solely for genuine merger discussions; discussion of any other matter would remain subject to the anti-collusion rules.

CONCLUSION

We appreciate the Commission's attention to this important topic, and we urge it to amend its competitive bidding rules as discussed above to ensure the integrity and competitiveness of its auction process. We hope you find our input helpful and are ready to assist you as you move forward in this effort.

Sincerely,

A handwritten signature in black ink, appearing to read "Joel I. Klein". The signature is fluid and cursive, with a large initial "J" and "K".

Joel I. Klein

cc: Commissioner James H. Quello
Commissioner Rachelle B. Chong
Commissioner Susan Ness